DEPARTMENT OF FINANCE

ARNOLD SCHWARZENEGGER, GOVERNOR

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January 27, 2006

Ms. Maureen F. Gorsen, Director
Department of Toxic Substances Control
1001 I Street
Sacramento, CA 95814

Dear Ms. Gorsen:

Final Report: Department of Toxic Substances Control—Internal Control Review

Enclosed is our final internal control report on the Department of Toxic Substances Control (Department) as of November 22, 2005. The Department of Finance, Office of State Audits and Evaluations, performed this review in accordance with the Financial Integrity and State Manager's Accountability Act of 1983, and pursuant to our interagency agreement with the Department.

The Department's response and our evaluation are included in the final report. Implementation of the proposed corrective actions will help strengthen the Department's internal control and improve fiscal operations.

We appreciate the assistance and cooperation of Department staff and management during our review. If you have any questions, please contact Richard R. Sierra, Manager, or Doris M. Walsh, Supervisor, at (916) 322-2985.

Sincerely,

Original signed by Diana L. Ducay

Diana L. Ducay, Chief
Office of State Audits and Evaluations

Enclosure

cc: Ms. Vicki Vandergriff, Deputy Director, Administrative Services, Department of Toxic Substances Control
Ms. Diane Sheridan, Chief, Audits and Special Investigations, Department of Toxic Substances Control
Ms. Sandra Poindexter, Chief, Business Services, Department of Toxic Substances Control
Ms. Kathy Hallet, Assistant Personnel Officer, Personnel, Department of Toxic Substances Control

An Internal Control Review

Department of Toxic Substances Control

Prepared By:
Office of State Audits and Evaluations
Department of Finance

063960013

November 2005

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PREFACE

The Department of Toxic Substances Control (Department) protects public health and the environment by: (a) regulating hazardous waste management activities, (b) overseeing or performing cleanup activities at sites contaminated with hazardous substances, (c) encouraging pollution prevention and the development of environmentally protective technologies, and (d) providing regulatory assistance and public education.

The Department is funded by environmental fees levied on businesses, grants from federal agencies, fines and penalties collected for violations of the hazardous waste control laws, reimbursement agreements, and cost recoveries from responsible parties.

State entity heads are responsible for the establishment and maintenance of internal and administrative controls. These controls are defined as a process to provide reasonable assurance regarding the achievement of objectives in the following categories: (a) reliability of financial reporting, (b) effectiveness and efficiency of operations, and (c) compliance with applicable laws and regulations. This definition includes five interrelated components:

- *Control environment* sets the tone of an organization, influencing the control consciousness of its staff. It is the foundation for all other components of internal control, providing discipline and structure.

- *Risk assessment* is the entity's identification and analysis of relevant risks to achievement of its objectives, forming a basis for determining how the risks should be managed.

- *Control activities* are the policies and procedures that help ensure management directives are carried out.

- *Information and communication* are the identification, capture, and exchange of information in a form and time frame that enable staff to carry out their responsibilities.

- *Monitoring* is the process that assesses the quality of internal control performance over time.

The objective of our internal control review was to assist the Department in complying with the Financial Integrity and State Manager's Accountability Act of 1983. Specifically, the review assisted the Department in determining whether: (1) assets are safeguarded from unauthorized use or disposition, (2) financial transactions are executed in accordance with management's authorizations and recorded properly to permit the preparation of reliable financial statements, and (3) financial operations are conducted in accordance with State Administrative Manual guidelines, state laws and regulations, and Departmental policies and procedures.

Our review did not include an evaluation of the efficiency or effectiveness of the Department's operations, or the accomplishment of program goals or objectives.

This report is intended for the information and use of the Department and should not be used for any other purpose. However, the report is a matter of public record and its distribution is not limited.

STAFF:

Richard R. Sierra, CPA
Manager

Doris M. Walsh
Supervisor

Ifeanyi Maduchukwu, CPA
Deborah Hanson
Lisa Negri
Dennis Solheim
Dennis Williams
Mark Zetterbaum

EXECUTIVE SUMMARY

As of November 22, 2005, many of the Department of Toxic Substances Control's (Department) internal controls were in place and working as intended; however, there were also other controls that could be improved to reduce the risk of errors, irregularities, and material misstatement, as summarized below. For further analysis refer to the *Findings and Recommendations* section of this report.

Administrative Controls: The Department has not taken corrective action to address 17 of 21 prior findings included in our May 2003 audit report. These unresolved findings present continuing internal control weaknesses that, if left uncorrected, increase the risk of material financial statement errors and irregularities.

Fixed Assets: The Department has significant weaknesses in its fixed asset controls and may be unable to adequately safeguard equipment or ensure the reliability and integrity of recorded data. The Department has incomplete and outdated policies and procedures, untagged equipment, incomplete and inaccurate property records, uncompleted physical inventory, and unreconciled accounting records. Consequently, the Department's $18 million in recorded fixed assets may be materially misstated.

Cash Receipts: The Department's cash receipts are correctly recorded and reconciled; however, there are opportunities for improvement in the physical control and timely endorsement and deposit of certain collections.

Receivables: Receivables are promptly billed and accurately recorded; however, overdue balances are not timely collected and control accounts are not regularly reconciled with subsidiary ledgers.

Purchasing: The Department's purchasing controls ensure that goods and services are justified, approved, and documented. The required separation of duties and existence of written policies and procedures are in place; however, the Department does not always pay invoices promptly, nor timely review outstanding encumbrances for validity.

Cash Disbursements: The Department's disbursement controls ensure the integrity and reliability of data. Except for a separation of duties weakness, cash disbursements are properly controlled, authorized, accurately recorded, and consistently reconciled.

Personnel/Payroll: Overall, the Department's payroll functions are sufficiently controlled. There are current policies and procedures and the required separation of duties; however, the Department could better control employee separation procedures.

Information Technology: While the Department's controls appear adequate to ensure the overall integrity and reliability of information assets, opportunities for improvement exist in systems access, operational recovery plans, and Information Security Officer duties.

Contracts: The Department's contracting controls appear adequate. There are current policies and procedures, adequate separation of duties, supporting documentation, and proper authorization, execution, amendment, and monitoring activities. There are no reportable conditions.

Financial Reporting: Although there were no specific weaknesses in the Department's preparation and submission of required annual reports, the internal control weaknesses noted throughout our report may indicate risks in the Department's ability to fiscally manage and control operations; and accurately record, process, summarize, and report financial data.

Revolving Fund: The Department's revolving fund controls include current policies and procedures, proper issuance and collection of salary and travel advances, and timely reconciliations. There are no reportable conditions.

Budget: The Department's budget controls appear adequate to ensure the reliability and integrity of data. The Department maintains current policies and procedures and timely records appropriations. There are no reportable conditions.

This report is intended to assist Department management in focusing attention on areas of risk, and in strengthening internal control and improving operations.

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AUDITOR'S REPORT

Mr. Leonard E. Robinson, Acting Director
Department of Toxic Substances Control
1001 I Street
Sacramento, CA 95814

We have reviewed the Department of Toxic Substances Control's (Department) internal control in effect as of November 22, 2005, for conformity with Government Code Section 13400 et seq. Our review included obtaining an understanding of the Department's internal control through observations and interviews, testing and evaluating the internal control design and operating effectiveness, and performing other procedures we considered necessary.

The Department's management is responsible for establishing and maintaining adequate internal control. This responsibility, in accordance with Government Code Section 13400 et seq., includes documenting internal control, communicating requirements to employees, and assuring that the internal control is functioning as prescribed. In fulfilling this responsibility, estimates and judgments by management are required to assess the expected benefits and related costs of control procedures. The objectives of internal control are to provide reasonable, but not absolute, assurance that:

- Assets are safeguarded against loss from unauthorized use or disposition.
- Transactions are executed in accordance with management's authorization and recorded properly to permit the preparation of reliable financial statements.
- Financial operations are conducted in accordance with policies and procedures established in the State Administrative Manual.

Because of inherent limitations in internal control, misstatements due to error or fraud may occur and not be detected. Also, projection of any evaluation of internal control to future periods is subject to the risk that the internal control may become inadequate because of changes in conditions, or that the degree of compliance with policies or procedures may deteriorate.

In reviewing the Department's internal control as of November 22, 2005, we noted certain matters involving the internal control and its operation that we consider to be reportable conditions. Reportable conditions involve matters coming to our attention relating to significant deficiencies in the design or operation of the internal control over financial reporting that, in our judgment, could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

A material weakness is a condition that precludes the Department's internal control from providing reasonable assurance that material misstatements in the financial statements will be prevented or detected on a timely basis. We believe the reportable conditions concerning fixed assets are material weaknesses. These weaknesses and other reportable conditions are described in the *Findings and Recommendations* section of this report.

This report is intended solely for the information and use of Department management and is not intended to be and should not be used by anyone other than this specified party. However, this report is a matter of public record and its distribution is not limited.

Original signed by Diana L. Ducay

Diana L. Ducay, Chief
Office of State Audits and Evaluations
(916) 322-2985

November 22, 2005

Findings and Recommendations

As of November 22, 2005, many of the Department of Toxic Substances Control's (Department) internal controls were operational and functioning as intended. Conversely, there were also several key controls that were not operational, and where corrective action is necessary as noted throughout this report. The conditions related to Fixed Assets are considered material weaknesses. If left uncorrected, these weaknesses may compromise the accuracy of the Department's financial statements.

Administrative Controls

Administrative controls relate to operational efficiency, adherence to managerial policies, and management's authorization of transactions. Department management is responsible for overseeing activities conducted within their agencies. The lack of corrective action on prior audit findings may impair the Department's ability to effectively control, prevent, and detect material errors in account balances and potential misappropriation of state assets. The following condition indicates a weakness in the Department's administrative controls.

FINDING 1 **Uncorrected Prior Findings**

Condition: Our May 2003 report on the Department's internal control identified 21 findings requiring corrective action. The final report indicated Department concurrence with the recommendations and its intention to take corrective action. Follow-up on these previously-reported findings indicates that Department management has corrected only three findings and has made progress in resolving one other. However, 17 of the prior findings remain uncorrected and require management's attention. The uncorrected findings are in the following cycles and the details are discussed elsewhere in this report.

- Fixed Assets
- Cash Receipts
- Receivables
- Purchasing
- Cash Disbursements
- Personnel/Payroll
- Information Technology

Criteria: The Financial Integrity and State Manager's Accountability Act (FISMA) of 1983 (Government Code Section 13400 et seq.) places responsibility for establishing and maintaining an agency's system of internal accounting and administrative control with the agency head.

State Administrative Manual (SAM) Section 20050 states that a symptom of control deficiency exists when detected internal control weaknesses are not acted upon in a timely fashion.

Recommendation: Develop and implement an action plan to promptly resolve the control weaknesses identified in this report, including any uncorrected weaknesses from the prior report. The action plan should be specific as to responsibilities and time frames.

Fixed Assets—Material Weaknesses

Effective asset controls safeguard property, plant, and equipment from unauthorized acquisition, use, or disposition. Since our prior audit, the Department has made strides to correct deficiencies by developing property registers and tagging equipment (although it could further enhance these procedures). The following material weaknesses in the Department's fixed asset controls significantly increase the risk that Department property could be lost or misappropriated, and that the reported $18 million property balance at June 30, 2005, may be materially misstated.

FINDING 2 **Inadequate Controls Over Fixed Assets**

Conditions: Corrective action is required in the following areas to ensure asset accountability and accurate reporting. All items are recurring conditions from the prior audit.

A. **Inaccurate and Incomplete Property Listings.** The Department has developed property registers for major assets (with unit costs of $5,000 or more); however, these registers are inaccurate and incomplete. Of ten property registers maintained by site, eight did not include a complete list of equipment serial numbers and/or tag numbers. Also, of six copiers located in the Department's headquarters office, one was not recorded in the property register. Moreover, the Department does not maintain property registers for minor equipment (with unit costs less than $5,000). Incomplete and inaccurate property listings impair effective asset identification and inventory.

B. **Unreconciled Property Accounts.** The Department does not periodically reconcile its general fixed assets account balances with subsidiary property registers, or annually reconcile real property with the Department of General Services' Real Property Inventory. Such reconciliations would help identify unrecorded property and facilitate physical inventories.

C. **Physical Inventories Not Conducted.** The Department has not conducted a physical inventory of property in the past three years. As a result, the Department may be unable to identify lost or stolen assets, or reconcile existing assets with the accounting records.

D. **Inadequate Property Survey Procedures.** The Department's Business Services Division does not consistently or timely forward property survey reports to the Accounting Unit. Consequently, the Accounting Unit is unable to identify and remove surveyed property from the general fixed assets account. Amounts reported in the year-end financial statements may be overstated.

E. **Inadequate Capitalization Procedures.** The Department improperly capitalized minor equipment totaling $66,120 in the general fixed assets account group. These items had unit costs less than $5,000.

F. **Inadequate Property Identification.** The Department does not tag minor/non-capitalized equipment, precluding effective identification and control of state-owned property. Although the Department tags all major/capitalized equipment, these tags are not sequentially numbered.

G. **Unissued Policies and Procedures.** The Department has not finalized and issued its revised asset polices and procedures.

Criteria:

SAM Section 8650 requires departments to record all property, whether capitalized or not, in a property accounting system (e.g. property register) showing detailed asset information. The capitalized segment serves as the subsidiary ledger for the General Fixed Asset Account Group.

SAM Section 7924 requires agencies to reconcile acquisitions and dispositions of capitalized property with the amounts recorded in the property register monthly or quarterly; and to reconcile their real property annually to the Department of General Services' Statewide Real Property Inventory.

SAM Section 8652 requires departments to perform a physical count of all property and reconcile the count with accounting records at least once every three years.

SAM Section 8640 requires departments to promptly prepare Property Survey Reports, STD. 152, when disposal of property occurs. These reports should be immediately forwarded to the accounting office for recording.

SAM Section 8602 states that only tangible property with a unit acquisition cost of at least $5,000 should be capitalized in the general fixed assets account group.

SAM Section 8651 states that all state property will be tagged after acquisition, including property that does not meet the state's capitalization requirements. Furthermore, the tags will be sequentially numbered.

SAM Section 20050 states that each system an entity maintains to regulate and guide operations should be documented through flowcharts, narratives, desk procedures, and organizational charts.

Recommendations:

A. Prepare accurate and complete property registers for all Departmental property showing the required details for each asset.

B. Reconcile subsidiary property register amounts with the general ledger monthly or quarterly.

C. Conduct a physical inventory of all Departmental property and reconcile the results with the property register and general ledger.

D. Timely submit all property surveys to the Accounting Unit for immediate deduction from the general ledger.

E. Only capitalize property with unit costs of $5,000 or more in the general fixed assets account group.

F. Affix sequentially-numbered tags to all Department property (major and minor), and ensure that this identifying information is accurately recorded in the property register.

G. Finalize and issue the revised fixed assets policies and procedures to all staff involved in asset management.

Cash Receipts

Effective collection controls ensure that all receipts are adequately safeguarded and promptly recorded. Although the Department accurately records and reconciles cash receipts, improvement is needed in cash safeguarding, endorsement, and deposit procedures.

FINDING 3 **Inadequate Cash Safeguards**

Conditions: Check collections and credit card payments are not adequately secured and checks are not promptly endorsed in the Department's Manifest Unit and Regional Environmental Assessors (REA) Program, as noted below.

A. Checks and credit card payments received in the Manifest Unit are not properly safeguarded to prevent unauthorized access or misappropriation. Trays containing hundreds of individual payments are routinely left unguarded in an unsecured room awaiting processing. To illustrate the exposure, the Manifest Unit processed $4.4 million in receipts during the first quarter of fiscal year 2005-06.

B. Credit card payments received in the REA Program are not adequately secured. Specifically, fax machines receiving credit authorizations are in open and unsecured areas, and the Program does not safeguard these authorizations prior to their transfer to the Accounting Unit.

Credit card payments totaled more than $21,000 during the first quarter of fiscal year 2005-06.

C. Checks received in the Manifest Unit and REA Program are not endorsed until after initial processing and transfer to the Accounting Unit. This transfer can take one or more days, precluding same-day endorsement.

This is a recurring condition from the prior audit.

Criteria: SAM Section 8032.1 requires agencies that do not have a safe, vault, or money chest adequate to safeguard cash to provide another mechanism of comparable safekeeping. Government Code Section 13403 requires a plan that limits access to state agency assets to authorized personnel who require these assets in the performance of their assigned duties.

SAM Section 8034.1 requires agencies to endorse checks, warrants, money orders, and other negotiable instruments on the day received.

Recommendations:

A. Secure all REA and Manifest checks and credit card payments in a restricted, locked area, and limit access to only authorized staff. Consider centralizing these collection functions within the Accounting Unit.

B. Restrictively endorse all negotiable receipts by the end of the day received.

FINDING 4 Receipts Are Not Deposited or Recorded Timely

Conditions: The Department does not always deposit and record cash receipts timely as noted below:

A. Manifest receipts (147 of 155) were deposited from 16 to 46 days after receipt.

B. REA receipts (28 of 50) were deposited from 11 to 89 days after receipt.

C. REA credit card payments (6 of 28) were recorded in the accounting records from 36 to 74 days after receipt.

Combined with the issues noted in Finding 3, these delays further increase the risk of loss.

Criteria: SAM Section 8032.1 states that accumulated receipts of any amount will not remain undeposited for more than ten working days. However, agencies that do not have facilities adequate to safeguard cash will deposit collections after they amount to $250 in cash or $10,000 in cash, checks, money orders, and warrants, whichever occurs first.

SAM Section 8030 requires agencies to report deposits in a timely and accurate manner in order to expedite the reconciliation of their agency accounts and to maximize interest earnings.

Recommendation: Promptly deposit and record all collections as required.

Receivables

Effective controls ensure that receivables are established for amounts due, are billed timely, and that outstanding balances are collected promptly. The Department accurately records account receivables and sends invoices timely; however, the following opportunities for improvement exist in its collection program.

FINDING 5 **Inadequate Collection Procedures**

Conditions: The Department does not have a comprehensive collection program encompassing all receivables types, and does not consistently and promptly follow required collection procedures, as noted below. All items are recurring conditions from the prior audit.

A. **Site Mitigation Program.** The Department does not send collection letters for contingent or valid Site Mitigation receivables when delinquent. Instead, the Department includes the total outstanding balance on the next quarterly invoice (which may include both overdue and current amounts). Collection efforts for substantially delinquent receivables are not documented. As a result, the Department is at risk of not collecting all amounts due.

B. **Hazardous Waste Management Program.** The Department has not taken adequate steps to collect delinquent Hazardous Waste Management receivables. Once a final collection notice is sent no further Departmental action is taken. In addition, the written collection procedures require improvement. While the procedures state that project managers are notified of delinquent accounts for follow-up, the procedures do not clearly specify the follow-up actions to be taken.

C. **Payroll Receivables.** The Department does not promptly notify employees of outstanding receivables nor collect amounts due. For two of three receivables tested, the employees were never notified of their outstanding balance.

D. **Dishonored Checks Receivable.** The Department does not timely send second and third collection letters for dishonored checks. Second and third letters were sent up to 31 and 20 days late, respectively.

E. **Advance Payments.** Certain Voluntary Cleanup Program agreements require the landowner/responsible party to make an advance payment to the state for work to be performed. The Department does not consistently track these advance payments nor follow-up on unpaid advances. In only one of three agreements tested was the required advance collected.

Criteria: SAM Section 8776.6 requires departments to develop collection procedures that will assure prompt follow-up on receivables, and also requires departments to send a sequence of three collection letters at 30 day intervals. If these letters are unsuccessful, SAM provides additional collection guidance. Section 8776.7 describes the procedures for collecting employee receivables.

Recommendations: Develop a comprehensive collection program encompassing all receivable types, to ensure prompt and consistent collection of delinquent receivables. This program should require timely preparation of collection letters and written documentation of collection efforts.

FINDING 6 **Lack of Accounts Receivables Reconciliations**

Condition: The Department does not reconcile monthly receivables recorded in the Toxic Substances Account (Fund 0557) with the subsidiary cost recovery billing system. As of June 30, 2005, the approximate receivable balance was $49.2 million. Although the Department is in the process of developing improved reconciliation procedures, the new procedures do not require monthly reconciliations. Failure to complete monthly reconciliations increases the risk of material, undetected errors and irregularities.

This is a recurring condition from the prior audit.

Criteria: SAM Section 7800 states that subsidiary records shall be reconciled to the general ledger monthly.

Recommendation: Reconcile the Toxic Substances Account (Fund 0557) receivables with the cost recovery billing system monthly.

Purchasing

Effective purchasing controls ensure that the Department acquires only authorized goods and services necessary for effective operations. The Department has adequate separation of purchasing duties, written policies and procedures, and effective authorization control; however, encumbrances and vendor payments could be better controlled as noted below.

FINDING 7 **Encumbrances Are Not Reviewed or Liquidated Timely**

Condition: The Department does not consistently and timely review outstanding encumbrances for validity. Fiscal year 2003-04 encumbrances were not reviewed until April 2005, at which time certain encumbrances had remained open for up to 19 months. In May 2005, the Department made inquiries to various program units regarding 20 open encumbrances; however, no additional follow-up was made on eight encumbrances for which no response had been received. Failure to timely review and liquidate outstanding encumbrances increases the risk of overstating obligations and decreases the funds available for program use.

This is a recurring condition from the prior audit.

Criteria: SAM Section 8340 requires agencies to carefully estimate encumbrances to ensure adequate amounts are reserved to meet anticipated expenditures, and to promptly adjust encumbrances upon final expenditure.

SAM Section 7952 requires agencies to review encumbrances at year-end for validity, and ensure that recorded amounts represent commitments for goods and services that will be received in the following year(s).

Recommendation: Review and follow-up on outstanding encumbrances periodically and at year-end to determine validity.

FINDING 8 Invoices Are Not Paid Timely

Condition: The Department does not timely schedule invoices for payment. Four of 43 tested invoices were scheduled for payment more than 30 days after receipt. The delayed payments were primarily due to the late preparation and submission of Stock Received Reports to the Accounting Unit.

This is a recurring condition from the prior audit.

Criteria: SAM Section 8474 requires departments to pay undisputed invoices and submit claim schedules to the State Controller's Office within thirty days of receipt.

SAM Section 8422.20 requires a stock received report, or signed copy of the order used as a stock received report, to be forwarded directly to the accounting office on the day the goods are received.

Recommendation: Promptly prepare and submit stock received reports to the Accounting Unit, and schedule invoices for payment within thirty days of receipt.

Cash Disbursements

Effective disbursement controls are important to safeguard blank checks and petty cash, and ensure that disbursements are authorized and documented. Except for the following separation of duties weakness, cash disbursements are properly controlled, authorized, accurately posted, and regularly reconciled.

FINDING 9 Inadequate Separation of Duties Over Cash Disbursements

Condition: Some of the Department's cash disbursement duties are not sufficiently separated. Specifically, the same Accounting Unit employee posts cash transactions to the general ledger, has access to blank check stock, and is the back-up custodian of the check signing machine key. Check access is generally incompatible with recordkeeping functions.

Criteria: SAM Section 8080 prohibits the same employee from concurrently operating a check signing machine (or having access to blank checks) and posting the general ledger or any subsidiary ledger affected by cash transactions.

Recommendation: Reassign the above duties to eliminate any conflicts in the cash disbursement function.

Personnel/Payroll

Effective personnel/payroll controls ensure that all employees are legitimate and authorized, compensation and benefits are correctly calculated, and separations are supervised. The Department's personnel controls are sufficient to ensure the reliability and integrity of employee data. The Department has current policies and procedures and adequate segregation of payroll duties; however, employee separations could be better controlled as noted below.

FINDING 10 Incomplete Employee Separation Procedures

Condition:

A. The Department did not complete exit clearance forms for nine of ten separating employees tested. These forms provide the Department with a method for ensuring that outstanding advances are collected prior to separation, that all state property is returned, and that facilities/data access is cancelled.

This is a recurring condition from the prior audit.

B. The final salary payment for two of the ten separated employees was incorrectly calculated, resulting in underpayments to the employees.

Criteria: Effective internal controls require a process to effectively transition separating employees from active status, recover any amounts owed, and secure any physical or information access from loss or destruction.

SAM Section 8580.4 states that Departments are responsible to ensure that payments to separating employees are in accordance with Labor Code Sections 201 and 202.

Recommendations:

A. Require completion of exit clearance forms for all separating employees. Do not release final payroll warrants until all clearances are completed and initialed.

B. Require a secondary review and recalculation of final salary payments for accuracy.

Information Technology

Effective information technology controls ensure that access to accounting system hardware and software is adequately controlled, data integrity is maintained, operational continuity plans exist, and key person dependency is avoided. Corrective action is required in the Department's system access, information security, and operational recovery procedures as discussed below.

FINDING 11 Inadequate Computer Access Procedures

Conditions:

A. The Department's information assets may be exposed to unauthorized use, modification, access, or disclosure because computer terminals continue to remain on when unattended. Some systems contain confidential employee and vendor information and financial data, and users share in the responsibility of protecting these assets by logging-off systems/applications when not in use. The Department's current computer policies and procedures do not address system access controls.

This is a recurring condition from the prior audit.

B. The Department does not timely update its list of employees authorized to access the CALSTARS system. The Department's Security File by Agency (CSB017-1) dated August 10, 2005, showed one employee who separated in December 2004 as having CALSTARS access. Tested Staff Change Requests (5 of 10) were processed from 45 to 221 days after employees separated or no longer required access.

This is a recurring condition from the prior audit.

Criteria:

SAM Section 4840.1 requires agencies to establish internal policies and procedures that protect and prevent misuse or loss of state information assets.

SAM Section 4842.2 states that agencies must include termination procedures that ensure information assets are not accessible to former employees.

Recommendations:

A. Establish written security policies and procedures that protect information assets, including required system log off procedures. Although it may not always be practical to log off systems, to reduce the risk of unauthorized access, the Department may want to explore alternative security methods, such as automatic security screensavers for the most critical systems.

B. Review the current CALSTARS access report for accuracy. Process Staff Change Requests immediately upon employee separation or transfer.

FINDING 12 **Information Security Officer Duties**

Condition: The Department's Chief of Special Investigations (Health Program Audit Manager I) also serves as the Information Security Officer (ISO). Because this employee conducts internal and external audits of various Department functions, there are inherent conflicts with some of the ISO's duties, particularly in the development and issuance of information security procedures. An independence conflict could arise should this employee audit or investigate issues associated with these security procedures.

Criteria: SAM Section 4841.1 outlines the duties of an agency's ISO and states that the ISO must be able to act in an independent manner and avoid conflicts of interest.

Government Code Section 1236 requires agencies with internal auditing activities to follow the *Standards for the Professional Practice of Internal Auditing* (SPPIA). These standards require the internal auditor to be independent of the activities they audit.

Recommendation: The Department should reassign the ISO function to an employee whose current duties do not conflict with those of an ISO. If reassignment is not possible, the Department should recuse the current ISO from any audits pertaining to information security.

FINDING 13 **Outdated Operational Recovery Plan**

Condition: The Department has not updated its operational recovery plan since August 2003. Further, the Department has not submitted its Operational Recovery Plan Certification, Risk Management Certification, or Department Designation Letter to the Department of Finance. An outdated operational recovery plan impairs the Department's ability to adequately plan and prioritize the recovery of critical applications and data.

This is a recurring condition from the prior audit.

Criteria: SAM Section 4845 requires all agencies to submit an operational recovery plan annually, or an operational recovery plan certification if no changes have taken place since the last submission. By January 31 of each year, each agency must also submit a department designation letter and risk management certification letter to the Department of Finance.

Recommendation: Update the operational recovery plan and submit the required certifications to the Department of Finance.

Conclusion

Our review of the Department of Toxic Substances Control's (Department) internal control presents opportunities for Department management to correct identified weaknesses and improve its operations. We believe internal controls would be strengthened and the Department would operate more effectively if management implements our recommendations. The internal control weaknesses, if left uncorrected, increase the risk that material errors or irregularities could occur and remain undetected, and could adversely affect the Department's ability to record, process, summarize, and report financial data consistent with the assertions of management in the financial statements.

The findings in this report are based on fieldwork performed between August 22, 2005 and November 22, 2005. We presented these findings and other issues to Department management on December 7, 2005.

Alan C. Lloyd, Ph.D.
Agency Secretary
Cal/EPA

Department of Toxic Substances Control

Maureen F. Gorsen, Director
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P.O. Box 806
Sacramento, California 95812-0806

Arnold Schwarzenegger
Governor

January 13, 2006

Ms. Diane L. Ducay, Chief
Office of State Audits and Evaluations
Department of Finance
915 "L" Street
Sacramento, California 95814

Dear Ms. Ducay:

Thank you for your draft report concerning the internal controls of the Department of Toxic Substances Control (DTSC). We appreciate your staff's efforts in evaluating the Department's administrative processes and the opportunity to respond to the findings and recommendations contained in your report. We believe that these recommendations will be valuable in strengthening the controls necessary to protect the State's assets and improve the efficiency of Department staff.

Enclosed, we have prepared our responses immediately following your recommendations. They are identified as "Response".

Should you have any questions concerning this report, please feel free to contact Ms. Diane Sheridan, Chief of the Audits and Special Investigations Unit, at (916) 322-0481.

Sincerely,

Original signed by Maureen F. Gorsen

Maureen F. Gorsen, Director

Enclosure

cc: Ms. Diane Sheridan, Chief
Audits and Special Investigations Unit
Office of the Assistant Director
Department of Toxic Substances Control

FINDING 2 Inadequate Controls Over Fixed Assets

Response:

DTSC has prepared a detailed corrective action plan identifying each of the corrective actions to be taken related to this finding. Submitted with DTSC's"Internal Control Certification" letter dated December 30, 2005, this plan outlines the corrective actions too be taken and the expected timeframes for completion to ensure asset accountability and accurate reporting.

It should be noted that DTSC does conduct an annual reconciliation of real property with the Department of General Services' (DGS) Real Property Inventory. The last reconciliation was submitted to the DGS on June 15, 2005.

FINDING 3 Inadequate Cash Safeguards

Response:

DTSC agrees that all collections must be secured in a restricted, locked area and limit access to only authorized staff. DTSC is looking into alternatives to comply with SAM regulations to safeguard agency cash.

A. DTSC is investigating the installation of a card reader for the cashiering room however; the cost of the door may prevent us from doing it. In addition, the ventilation system for the room needs to be modified, creating an additional cost. In the meantime, the cashiering unit staff were instructed to lock the door of the cashiering room at all times when no one is in the room to prevent unauthorized access or misappropriation of credit cards and checks.

B. When the REA Program moved from its' Headquarters location to the Sacramento Regional Office, a secured fax was installed. The fax machine is located in the Regional Coordinator's private office and the office door is locked when not occupied.

C. We recognize the problem and agree that all cash receipts should be restrictively endorsed by the end of the day. The REA Program will purchase an endorsement stamp so checks can be endorsed prior to transmittal to HQ. However, checks received in the Manifest Unit are significant in number and because of limited resources, the DTSC can only endorse the receipts that were opened and processed by the end of the day.

FINDING 4 Receipts Are Not Deposited or Recorded Timely

Response:

DTSC agrees that all cash receipts should be restrictively endorsed by the end of the day in which they are received. However, due to the large volume of mail (Manifest) that comes in during the peak season and the limited resources, only the processed during the day are deposited and recorded timely.

FINDING 5 Inadequate Collection Procedures

Response:

DTSC agrees that a comprehensive receivables program is ideal. DTSC is developing policies and procedures to address the various types of transactions we have and intends to consolidate these. The types of invoices DTSC issues, and the types of collections it receives, vary considerably from the normal chattel transactions that the auditor and State Administrative Manual (SAM) refer to. We understand and use SAM as a guide; however, due to the nature of our receivables and our procedures (some required by statute), SAM guidelines may not always fit our situations. However, we establish receivables as appropriate, follow-up our collection efforts with notifications; and we believe we have procedures which are adequate to protect and accurately reflect the assets of the State.

A. **Site Mitigation Program.** We agree that follow-up on overdue receivables should be done and the DTSC does pursue receivables systematically. However, we do not agree with the auditor's recommendation that the DTSC should send a sequence of 30 day follow up letters for our cost recovery invoices in our Site Mitigation program. Since the law allows 60 days for the Potentially Responsible Parties (PRPs) to pay cost recovery bills for site mitigation activities, it would be counterproductive to send 30 day follow-up collection letters since that would be prior to the payment due date. In addition, since some bill recipients do not admit to any legal liability or responsibility to pay, or are in litigation with the DTSC, their insurance companies, or other PRPs, 30 day follow up collection letters would not produce results in such circumstances. However, quarterly bills include overdue invoice details and are included with every bill until the overdue balance is paid or settled. In addition, program staff separately contacts PRPs to request payment of overdue invoices. The DTSC continues to believe that this approach is appropriate given the unique billing circumstances of this program.

B. **Hazardous Waste Management Program.** DTSC is in the process of moving the Hazardous Waste Management Program billings to the Cost Recovery Billing System. We anticipate that this will take place in late Fiscal Year 2006-07. Therefore, since the majority of DTSC's cost recovery activity is in the Site Mitigation program, we do not want to develop further cost recovery action and other receivable procedures for the Hazardous Waste Management Program. DTSC, will however, review the current list of outstanding receivables to discuss appropriate collection measures.

C. **Payroll Receivables.** Three receivables were tested. The two cases where the employees had not been notified of the receivables were from 2000 or earlier. These are in the process of being written off.

To ensure a higher level of staff accountability, all documentation related to the generation and collection of accounts receivables is received and logged by the Senior Personnel Specialist (SPS) prior to distribution to transaction staff. The SPS and the Assistant Personnel Officer receive a report from the Accounting Unit on a monthly basis. That report and our log are reconciled each month.

Further, since the 2003 audit the Human Resources Branch transactions staff has received training on noticing employees and clearing accounts receivables. Employees are notified within five working days of the transaction staff being made aware of the accounts receivable.

D. **Dishonored Checks Receivable.** Procedures are in place and are being implemented for staff to send the second and third collections letters on a timely basis. The supervisor will review and follow-up the implementation of the procedures on a monthly basis.

E. **Advance Payments.** The DTSC agrees that advance payments should be tracked and follow up on unpaid advances should be done. We will review our options to develop a process that will have minimal impact on staff time and resources.

FINDING 6 Lack of Accounts Receivables Reconciliations

Response:

The DTSC agrees that reconciliation of the general ledger and subsidiary ledger for accounts receivable in the Toxic Substances Account (Fund 0557) is necessary. We will reconcile these accounts quarterly, as staff limitations and priorities allow.

FINDING 7 Encumbrances Are Not Reviewed or Liquidated Timely

Response:

Business Services and Accounting Management staff have developed and implemented procedures to monthly review executed Purchase Orders (PO) to identify those that have been cancelled and/or cancelled and reordered by requesting staff without following procedures. The Accounting Office will be reconciling the document files in the CALSTARS (D16) with Business Services encumbrance listing to review and follow-up the validity and accuracy of open encumbrances monthly.

FINDING 8 Invoices Are Not Paid Timely

Response:

The DTSC agrees that stock received reports should be accurate, complete, and submitted timely to the Accounting Office. A memorandum, signed by the Administrative Services Deputy Director will be sent to all staff reminding them to submit the Stock Received Report to the Accounting office within 48 hours to allow prompt payment of invoices.

FINDING 9 Inadequate Separation of Duties Over Cash Disbursements

Response:

The DTSC agrees that there should be separation of duties over Cash Disbursement. The duties of the cash disbursement staff who concurrently was operating a check signing machine (or having access to blank checks) has been re-assigned to another staff.

FINDING 10 Incomplete Employee Separation Procedures

Response:

A. Current policy dictates that exit clearance forms are required for all separating employees. Retaining final payroll warrants until all clearances are completed and initialed is not feasible due to the restrictions in the Labor Code requiring that all employees be paid within 72 hours of separating. HR staff request the exit clearance form as soon as learning of an employee's pending departure.

HQ personnel staff will continue to contact the manager of the departing employee on a regular basis until the document is received.

B. Prior to the audit and continuing, it is DTSC procedure that final salary payments be reviewed and approved by one of the two Assistant Personnel Officers. The two errors discovered in the audit did not have secondary review. This policy and procedure will be conveyed to transactions staff.

FINDING 11 Inadequate Computer Access Procedures

Response:

The DTSC will modify it's DO 3-04-06, "DTSC Information Technology Resources Usage and Security" policy, dated July 15, 2005, to incorporate a requirement that employees who access confidential, sensitive, or personal data from their desktop or laptop computers, or from other IT devices, either log-off or otherwise lock the desktop from non-password access whenever they leave their workstations. Until such time as that policy modification is made, the ISO will, by email, advise supervisors and managers of the requirement.

The DTSC concurs with the finding. Procedures are in place for the review of the current CALSTARS access report for accuracy. Supervisors are reminded to process Staff Change Request immediately upon employee separation or transfer.

FINDING 12 Information Security Officer Duties

Response:

The DTSC's Health Program Audit Manager I (HPAM I), does not "primarily function as the DTSC's chief internal auditor". Primary functions of this employee include providing technical assistance to program and enforcement staff by conducting financial reviews to determine the ability to pay cost recovery liabilities, fines, and penalties.

It should be noted however, that with transfer of the REA Program to the DTSC in July 2003, the HPAM I was asked by the DTSC's Chief Deputy Director, to conduct a management review of the REA Program. This management review was completed in September 2004, prior to the assumption of duties related to information security.

Because of the limited nature of these types of internal reviews and with a limited number of staff, future assignments of this type will be evaluated on a case-by-case basis, and in all instances pertaining to information security would recuse the Information Security Officer from responsibility related to security audits.

FINDING 13 Outdated Operational Recovery Plan

Response:

The DTSC will soon fill a newly-established Data Processing Manager III as an Assistant Chief Information Officer. Among that individual's responsibilities are:

A. Acts as the main interface between the DTSC and State control agencies on all matters related to information technology. These duties will include, the development of feasibility study reports and other complex technical and budgetary analyses. This will include ensuring accurate preparation and timely submission of all of the various required IT reports and certifications.

Evaluation of Response

We have reviewed the Department's response and acknowledge its agreement to implement most of the reported recommendations. Implementation of the planned corrective actions will strengthen the Department's internal control and reduce the risk of undetected errors or irregularities.

The Department disagreed or partially disagreed with Findings 2.B, 4, 5.A, 10.A, and 12. We found no additional information that would cause us to modify the reported facts; therefore, the findings and recommendations will remain as stated in the report. Moreover, many of our recommendations provide the Department some latitude in developing appropriate corrective actions. Because the Department assumes responsibility for risks it deems impractical or uneconomic to fully implement, it should consider alternative, cost effective steps to minimize these risks.

Finding 12 was revised to clarify the Special Investigations Chief's duties.